

MPS REVIEW

ISSUE # 24 | JUNE 16, 2026

A Brief Assessment of SBP's Monetary Policy on Business and Economy

ICMA Research and Publications Department

Preamble

The State Bank of Pakistan's (SBP) Monetary Policy Committee (MPC), in its June 15, 2026 meeting, kept the policy rate unchanged at 11.50 percent. The ongoing Middle East conflict has begun to weigh on key indicators, with headline inflation rising to double digits in April and May and core inflation edging higher year on year. Economic activity moderated amid elevated prices, austerity measures, and uncertainty, leading the MPC to judge that the current stance remains appropriate to guide inflation toward the medium-term target of 5–7 percent.

On the domestic side, provisional GDP growth for FY26 was estimated at 3.7 percent, while SBP forex reserves rose to \$17.2 billion by June 5, 2026, supported by IMF reviews and FX purchases. The government reported a primary balance surplus of 2.5 percent of GDP for FY26, with a target of 2.0 percent for FY27. The MPC reaffirmed its commitment to proactive macroeconomic management, fiscal consolidation, and structural reforms to sustain growth and resilience against supply shocks.

ICMA's latest assessment, drawing on the Monetary Policy Evaluation Group (MPEG) framework, underscores that current inflationary and liquidity pressures are outpacing earlier policy rate signals. Headline inflation has surged into double digits, core inflation continues to edge higher year on year, and while on the other hand, SBP forex reserves are estimated to reach \$18 billion by the end of June 2026.

Against this backdrop of elevated prices, exchange rate volatility, and seasonal cash demand, the MPC reaffirmed its commitment to guiding inflation toward the 5–7 percent medium-term target while maintaining fiscal discipline and structural reforms to sustain growth.

ICMA's MPEG Analysis Shows Monetary Transmission Under Pressure from Inflation, Exchange-Rate and Liquidity Conditions

As inflationary pressures re-emerge amid rising energy costs, supply-side disruptions and geopolitical uncertainty, the key policy question is no longer limited to whether the policy rate is high or low. The more important question is whether the earlier policy stance remains strong enough to absorb inflationary, exchange-rate and liquidity pressures. To assess this, ICMA has applied the Monetary Policy Effectiveness Gap (MPEG) framework, which compares the four-month lagged SBP policy rate with current headline CPI inflation, exchange-rate growth and currency in circulation growth¹.

Liquidity pressure is relevant in the current period, as currency in circulation usually rises around Eid due to higher cash withdrawals and household spending, while upcoming Muharram may keep seasonal cash demand elevated. These movements do not reflect policy weakness; they simply show why monetary transmission should be assessed alongside liquidity, exchange-rate and supply-side pressures. The idea of the MPEG framework is drawn from international monetary transmission literature, including IMF Working Paper, IMF World Economic Outlook and BIS Paper.

¹ For Pakistan, the four-month lag is adopted as an operational lag for assessing monetary policy transmission, based on recent Pakistan-specific evidence by Mahmood et al. (2025). The use of a lagged policy framework is also supported by Hetzel (2012), which emphasizes that monetary policy evaluation should be based on an explicit analytical framework linking policy actions with macroeconomic outcomes.

Monetary Policy Effectiveness Gap (MPEG) Model

The Monetary Policy Effectiveness Gap (MPEG) tracks whether SBP's earlier policy rate stance is strong enough to absorb current inflationary, exchange-rate and liquidity pressures. It compares the four-month lagged policy rate with headline CPI inflation, exchange-rate growth and currency in circulation growth.

$$\text{MPEG} = \text{Policy Rate}_{t-4} - \text{CPI Inflation} - \text{Exchange Rate Growth} - \text{Currency in Circulation Growth}$$

Where:

Policy Rate_{t-4}: SBP's MPC-decided policy rate lagged four months

CPI Inflation: Current headline CPI inflation on a year-on-year basis.

Exchange Rate Growth: Growth in the PKR/USD exchange rate, capturing imported inflation pressure.

Currency in Circulation Growth: Growth in currency held outside the banking system, capturing liquidity and seasonal cash demand pressure.

Rule to Judge:



MPEG < 0: Weak Monetary Transmission

MPEG ≈ 0: Neutral Monetary Transmission

MPEG > 0: Effective Monetary Transmission

Table 1: Monetary Policy Effectiveness Gap (MPEG) Analysis

Period	PR _(t-4)	INF	ER	CC	MPEG
Jan-25	17.5	2.4	-0.2	8.2	7.1
Feb-25	17.5	1.5	0.3	11.3	4.5
Mar-25	15	0.7	0.8	18.1	-4.6
Apr-25	13	0.3	1.0	14.1	-2.4
May-25	12	3.5	1.3	17.3	-10.1
Jun-25	12	3.2	1.9	17.1	-10.2
Jul-25	12	4.1	1.6	18.7	-12.3
Aug-25	12	3.1	1.2	18.3	-10.5
Sep-25	11	5.8	1.4	18.9	-15.1
Oct-25	11	6.2	1.2	18.3	-14.6
Nov-25	11	6.1	1.0	19.4	-15.5
Dec-25	11	5.6	0.7	19.1	-14.4
Jan-26	11	5.8	0.4	19.9	-15.1
Feb-26	11	7	0.0	19.8	-15.8
Mar-26	11	7.3	-0.3	18.8	-14.8
Apr-26	10.5	10.9	-0.7	16.7	-16.4
May-26	10.5	11.7	-1.2	19.8	-19.8

Source: SBP, PBS, and ICMA Calculation

Note: Exchange Rate growth and Currency in Circulation growth are calculated on year-on-year basis.

Interpretation

- ICMA's MPEG analysis shows that monetary transmission remained effective in January and February 2025, with MPEG standing at 7.1 percentage points and 4.5 percentage points respectively. During this period, the four-month lagged policy rate was strong enough to absorb headline inflation, exchange-rate movement and currency in circulation growth.
- From March 2025 onward, the MPEG turned negative, mainly due to elevated currency in circulation growth. This reflected higher cash demand during Ramadan and Eid-related spending, recovery in consumer activity, and continued reliance on cash-based transactions. Although headline inflation remained low in several months, liquidity held outside the banking system reduced the remaining effectiveness gap and tested monetary transmission beyond inflation alone.
- The pressure became more visible during September 2025 to February 2026, when the MPEG remained deeply negative despite a stable lagged policy rate of 11.0 percent. During this period, inflation gradually increased while currency in circulation growth remained close to 19 percent. This suggests that seasonal and transaction-based cash demand continued to influence liquidity conditions, limiting the strength of policy-rate transmission.
- In April and May 2026, the MPEG weakened further as headline inflation rose sharply to 10.9 percent and 11.7 percent respectively. Although exchange-rate growth turned negative, showing some easing in exchange-rate pressure, this was not sufficient to offset the combined impact of higher inflation and strong currency in circulation growth. As a result, the MPEG declined to -16.4 percentage points in April 2026 and -19.8 percentage points in May 2026.

The numbers for April and May 2026 leave little room for complacency. Inflation has surged past 11 percent, and liquidity pressures remain stubbornly high as most of Pakistan's economy still operates outside the formal banking system. This reality means that interest-rate policy alone cannot deliver the intended transmission. Cutting rates now would risk fueling inflation further, while holding steady is the only prudent choice in the short term. But stability will not come from monetary policy alone. Unless fiscal consolidation is sustained, the tax base broadened, and more people and businesses are drawn into the formal financial system, monetary decisions will continue to underperform. Policymakers must therefore treat the current stance as a holding line — one that buys time for deeper reforms in fiscal management, energy costs, and financial inclusion to restore credibility and ensure that monetary policy delivers on its promise.

ICMA Policy Recommendations

1. Maintain a Cautious Monetary Stance

SBP may continue with a cautious monetary stance while allowing the lagged impact of earlier policy decisions to transmit through the economy. Since the current pressure is partly driven by inflation and liquidity conditions, any further policy action should be carefully calibrated to avoid unnecessary pressure on productive sectors.

2. Strengthen Liquidity Monitoring Around Seasonal Periods

SBP may closely monitor currency in circulation, especially around Eid, Muharram and other high-cash-demand periods. Better tracking of seasonal liquidity movements can help distinguish temporary cash demand from persistent liquidity pressure and support timely policy assessment.

3. Improve Coordination Between Monetary and Fiscal Management

Continued coordination between monetary and fiscal authorities can help maintain macroeconomic stability. Cautious and logical fiscal management decisions, including controlled borrowing requirements and efficient cash-flow planning can support SBP's monetary stance and reduce excess liquidity pressures in the system.

4. Support Targeted Supply-Side Measures

Targeted measures to ease cost pressures in energy, transport and key production inputs can complement monetary policy. Such measures can help contain cost-push inflation without relying only on broad-based interest-rate adjustments.

5. Institutionalize MPEG as a Monthly Monitoring Tool

MPEG should be adopted as a supplementary monthly policy indicator alongside inflation, exchange-rate movement, credit conditions, and liquidity indicators. This can help identify early signs of weakening monetary transmission and provide a more complete view of policy effectiveness.

ICMA's Research & Publications (R&P) Department gathered views from experts and business leaders on SBP's June 15 decision to keep the policy rate unchanged at 11.5 percent. Their perspectives stressed that persistent inflationary pressures, exchange-rate volatility, and liquidity conditions require a cautious stance, with monetary policy focused on anchoring expectations and reinforcing stability.

Experts' Insight

Prof. Dr. Nooreen Mujahid, Director of the Applied Economics Research Centre (AERC), while sharing her views with the ICMA Research and Publications Department, endorsed the SBP's decision to maintain the policy rate at 11.5% as a balanced response to resurging inflation and lingering external sector risks. She observed that inflation remains above SBP's target range, while the return of the current account deficit and continued sensitivity to energy import costs warrant policy caution. She further noted that the Federal Budget's focus on fiscal consolidation and debt sustainability complements the SBP's stabilization-oriented stance, reinforcing macroeconomic discipline. While tighter financial conditions may moderate private-sector borrowing and investment in the short term. Dr. Noreen, argued that premature monetary easing could weaken inflation expectations, intensify exchange-rate pressures and erode recent stabilization gains. As per her analysis, maintaining a positive real interest rate is essential to anchor inflation expectations, preserve investor confidence, and reinforce policy credibility, while also safeguarding external sector stability and preventing temporary supply-side shocks from evolving into persistent inflationary pressures that could undermine macroeconomic resilience.

Mr. Zulfiqar Alam, Chief Executive Officer of Pakistan Housing Finance Company Limited (PHFC), observed that although headline inflation has accelerated, the current inflationary episode remains largely supply-driven and externally induced rather than demand-led. He noted that energy prices, imported inflation, food supply disruptions, tariff adjustments, and structural inefficiencies continue to be the principal drivers of price pressures. In his view, the SBP's decision is appropriate under prevailing conditions. However, it should be regarded as a transitional stance, with scope emerging for a gradual and forward-looking monetary easing cycle once inflation demonstrates sustained moderation. He further emphasized that the Federal Budget's growth objectives, particularly those aimed at supporting businesses and SMEs, require close coordination between fiscal and monetary policies. While targeted tax relief measures may help reduce the cost of doing business, their effectiveness remains constrained by elevated borrowing costs. He argued that a calibrated, data-driven reduction in interest rates, once inflation is firmly contained, would complement fiscal initiatives by improving liquidity, lowering the cost of capital, expanding credit to productive sectors, and supporting sustainable and inclusive economic growth.

Dr. Nasir Iqbal, Professor of Economics, Pakistan Institute of Development Economics (PIDE), stated that holding rate at 11.5% was predictable call consistent with the FY27 Budget particularly in light of easing external pressures following the US–Iran signing an MOU and a softer global oil outlook. He cautioned against interpreting this pause as a sign of easing inflationary dynamics, highlighting that headline inflation has increased from 7.3% in Mar-26 to 11.7% in May-26, while core inflation has risen to approximately 8.7% in May on YoY basis, driven by lagged pass-through effects in energy, transport, wheat, and food categories. In his view, the MPC's stance reflects a calibrated stabilization strategy, allowing the transmission of the prior 100 basis points tightening to materialize rather than responding further to supply-side inflationary impulses. He argued that Pakistan's growth constraints are predominantly structural, including low savings and investment ratios, weak contract enforcement, policy uncertainty, and institutional inefficiencies. While the SBP's decision supports IMF programme credibility, reserve accumulation approximately \$17.2–18 billion, and fiscal consolidation targets primary surplus of 2–2.5% of GDP, it does not, in itself, generate sustained growth, which remains contingent on comprehensive structural and governance reforms.

Prof. Dr. Shahida Wizarat, a Renowned Economist, has repeatedly argued that equating inflation with interest rate policy is economically flawed. She notes that current inflation is largely driven by cost-push factors, particularly rupee depreciation, which has raised import costs for energy, industrial raw materials, and capital goods, thereby escalating the overall cost of doing business. In her view, the policy response of raising interest rates to curb inflation assumes demand-pull pressures that are not actually present in the economy. Instead, with demand remaining largely stagnant, inflation persists due to external cost pressures rather than domestic overheating. She further cautions that aligning monetary tightening with IMF conditionalities risks deepening economic slowdown, as either maintaining high rates or further increases could suppress growth without addressing the structural sources of inflation.

Industry's Perspective

Mr. Atif Ikram Sheikh, President of the Federation of Pakistan Chambers of Commerce and Industry (FPCCI), while responding to the ICMA Research and Publications Department, stated that the SBP's decision to keep the policy rate unchanged appears misaligned with the broader objective of accelerating economic growth, industrial revival, and export competitiveness. He acknowledged SBP's mandate to manage inflation and external stability but argued that recent macroeconomic improvements moderating inflation from peak levels, strengthened foreign exchange reserves, and relative exchange-rate stability create adequate space for a gradual easing cycle. He further noted that prolonged high borrowing costs are increasingly distorting economic activity by discouraging long-term investment, compressing SME margins, and shifting business focus toward survival rather than expansion. In his view, this also weakens export competitiveness at a time when regional peers are benefiting from lower financing costs. He stressed that a single-digit policy rate is critical not only for stimulating investment but also for improving credit penetration, supporting industrial capacity utilization, and unlocking private-sector-led job creation. On the Federal Budget 2026–27, he observed that while the government has introduced meaningful pro-business tax rationalization measures, export facilitation, and relief in transactional taxes their effectiveness remains constrained by tight monetary conditions. He emphasized that without a coordinated monetary easing path, fiscal incentives cannot fully translate into productive investment, highlighting the need for stronger alignment between SBP policy and fiscal objectives to restore investor confidence, improve liquidity conditions, and support a sustainable growth trajectory.

Mr. Usman Shaukat, President of the Rawalpindi Chamber of Commerce & Industry (RCCI), reiterated the business community's longstanding demand for a gradual return to a single-digit policy rate. He observed that decision to maintain the policy rate at 11.5% reflects a cautious approach, there was adequate room to initiate monetary easing. Referring to the increase in inflation from 7.3% in March to 11.7% in May 2026, he maintained that the rise was largely attributable to imported energy costs stemming from Middle East tensions rather than demand-side pressures within the domestic economy. With prospects of a US–Iran truce and international oil prices retreating from recent highs, he expected these inflationary pressures to moderate in the coming months. He further emphasized that double-digit financing costs continue to impede SMEs, manufacturers, and exporters and called on the SBP to begin unwinding recent monetary tightening and establish a credible roadmap toward lower interest rates to stimulate investment, employment and export-led growth.

Mr. Muhammad Raza, Senior Vice-President of Karachi Chamber Commerce & Industry (KCCI), noted that policy rate remaining unchanged fell short of expectations for a policy reversal amid signs of macroeconomic stabilization. The earlier 100-basis-point increase was introduced in response to inflationary pressures and heightened geopolitical uncertainty. However, recent easing in global tensions and moderation in international oil prices have improved the external risk landscape. He argued that persistently high interest rates continue to elevate the cost of capital, compress industrial profitability, and constrain credit-driven expansion. He further emphasized that elevated financing costs are weakening export competitiveness and discouraging private investment in an already cost-intensive operating environment. Reaffirming the Chamber's position, Mr. Raza stressed the need for a calibrated transition toward a single-digit policy rate to restore business confidence and align monetary conditions with growth objectives. He added that the current stance appears misaligned though he remained cautiously optimistic that further easing in global geopolitical and energy-related risks could create space for monetary easing in upcoming SBP policy deliberations.

Mr. Asfandiyar Farrukh, Chairman and Co-Founder of the Chainstore Association of Pakistan, observed that prevailing inflationary pressures are mainly cost-push and imported by energy, electricity, commodity prices, and input costs which are not directly addressed through high interest rates. He further cautioned that persistently elevated rates continue to increase business financing and expansion costs while also amplifying the Government's debt-servicing burden, thereby constraining overall economic momentum. In his view, the current policy stance provides a degree of stability and predictability that is essential for business planning, investment decisions, and job creation. He added that while the monetary stance is broadly aligned with the Federal Budget's stabilization objectives, sustainable growth will require complementary fiscal discipline, energy-sector reforms, tax-base broadening without overburdening compliant businesses, and consistent policy direction to enable lower financing costs and strengthen private-sector-led expansion.

MPC Observations on Key Sectors

Real Sector

- Real GDP provisionally estimated at 3.7 percent for FY26, reflecting pressures from the Middle East conflict and austerity, dampening the earlier growth momentum.
- LSM posted cumulative growth of 6.5 percent during July–March FY26, supported by strong performance in automobiles, motorcycles, and construction-related industries.
- Agriculture outlook remains positive, with major crops including sugarcane, wheat, rice and maize high-production in FY26, though cotton output remained below the government target.
- High-frequency indicators remained supportive; passenger car sales reached 140,253 units during July–May FY26, compared to 94,544 units in the same period last year, while motorcycle sales grew to 1,793,569 units from 1,380,243 units, reflecting sustained consumer demand.
- **Outlook:** FY27 growth may face some pressure from moderation in industry and services, along with subdued agriculture prospects due to challenging weather conditions and early concerns around Kharif crops.
- Despite lower revenues, the government expects a primary surplus of 2.5% of GDP in FY26, and 2.0% in FY27.
- Policy focus remains on continued fiscal consolidation, tax base broadening, and reduction in SOE losses to sustain macroeconomic stability.
- **Outlook:** Continued fiscal consolidation, tax base broadening and PSE reforms will remain important for supporting macroeconomic stability and reducing pressure on monetary policy.

Money and Credit

- Broad money (M2) growth stood at 14.3 percent YoY as of May 2026, moderating from 14.5 percent in April 10, 2026, driven by reduced government borrowing from banks.
- Credit to the private sector expanded to 13 percent, with increase in working capital, fixed investment and consumer financing.
- **Outlook:** Liquidity conditions need close monitoring, especially around seasonal cash-demand periods. Continued moderation in budgetary borrowing and careful liquidity management can support monetary transmission and private sector credit availability.

External Sector

- Current account recorded a cumulative deficit of \$0.2 billion during July–April FY26, reflecting a broadly contained external position despite global trade disruptions.
- SBP's net foreign exchange reserves stood at \$17.2 billion as of June 5, 2026, supported by successful completion of IMF reviews for EFF and RSF.
- Workers' remittances remained a key pillar of external stability, in May, it is expected to keep the current account deficit at the lower end of the projected range for FY26, despite global challenges.
- **Outlook:** The current account deficit may widen somewhat in FY27, but reserve buildup is expected to continue, supported by planned official inflows and ongoing FX purchases.

Inflation

- Headline inflation rose sharply to 10.9 percent in April 2026 and further to 11.7 percent in May 2026, driven primarily due to hike in domestic energy prices, transport cost escalation, and supply-side disruptions linked to the Middle East conflict.
- Core inflation increased to 8.7 percent in May 2026 from 8.2 percent in April 2026, indicating that second-round effects of the energy shock are beginning to transmit into broader price pressures.
- **Outlook:** Inflation may remain in double digits over the next few months before gradually easing. Key risks include geopolitical developments, pass-through of global prices to domestic fuel prices, power and gas tariff adjustments, potential fiscal slippages and uncertain food prices due to weather-related challenges.

Fiscal Sector

- Revenue growth moderated, prompting the FBR to revise its FY26 target to around Rs13 trillion.